

The Adoption Credit



Introduction

- Two Benefits available:
 1. A nonrefundable credit of up to \$10,390
 2. An exclusion from income of up to \$10,390 for qualified expenses paid for by an employer under an adoption assistance program.



Overview

- Qualified expenses
- Eligible child
- Foreign adoptions
- Filing requirements
- Income limitation
- Reimbursed expense exclusion
- Calculation of credit



Vocabulary

- Credit defined
- Exclusion defined



Non-refundable credit

- Non-refundable credits reduce the tax liability, but do not provide a refund.
- Qualified adoption expenses can reduce the tax liability to zero; but if the credit is more than the tax liability, the taxpayer is not provided a refund.

Exclusion

- Qualified employer adoption assistance payments are not required to be included in income. They are excluded.



Qualified Expenses

Expenses must first be reasonable and necessary for the legal adoption of an eligible child.



Qualified Expenses

Qualified expenses include:

- Adoption fees,
- Court costs,
- Attorney fees,
- Travel, including meals and lodging while away from home,
- any other expense directly related to, and for the principal purpose of, the legal adoption of an eligible child.

Qualified Expenses

Does not include any expense:

- Which violates state or Federal law,
- incurred in surrogate parenting arrangements,
- incurred in adopting spouse's child,
- paid using funds from Federal, state or local program,
- claimed as deduction or credit elsewhere on return,
- paid or reimbursed by an employer (exception).

Example

- Joe and Edna live in Georgia and adopted a child born in California:

\$3,000 fees paid to church sponsored adoption agency.

\$2,000 attorney and court costs to finalize adoption

\$1,500 travel, including meals and lodging to travel to CA & pick up the child.

When to deduct

- For any expense paid before the year the adoption becomes final, deduct in the following year.
- For any expense paid during or after the year the adoption becomes final, deduct in year paid.

Example

- \$1,000 fee is paid to the Agency in 2003. \$4,000 is paid when a child is placed in 2004. The adoption is finalized in 2005.

Answer: The \$1,000 is claimed on 2004 return, \$4,000 is claimed on 2005 return.

Example

- If adoption is finalized in 2004:

Answer: \$5,000 credit is claimed on 2004 return.

Eligible Child

- Under age 18, or
- Physically or mentally incapable of caring for himself.
- Special needs relates to age, ethnic background, and physical, mental, or emotional condition.



U.S. Citizen or resident

- If the eligible child is a U.S. citizen or resident, you can take the adoption credit or exclusion even if the adoption never becomes final.

Special Needs

- Beginning in 2003, a credit or exclusion of \$10,390 is allowed for the adoption of a child with special needs even if you do not have any qualifying expenses.



Foreign Adoptions

- No credit or exclusion is allowable for adoption of a foreign child until the adoption becomes final.
- Additional rules (see pub. 968, pg. 3 & 4)



Filing Requirements

- Single, Head of Household, Qualifying Widow(er), or Married Filing Joint. MFS separate rules apply.
- MAGI less than \$195,860.
- Must furnish the name, age, and TIN of the eligible child.
- File W-7 A to apply for TIN. Cannot obtain SSN until adoption finalized.

Income limitation

- Phase-out of excludable amount and/or refundable credit begins when modified AGI exceeds \$155,860 and is fully phased out when exceeds \$195,860.



Dollar Limit

- Limited to \$10,390 for each effort to adopt.
- An attempt that leads to the successful adoption of a child and any unsuccessful attempt to adopt a different child are treated as one effort.

Reimbursed expense Exclusion

- Up to \$10,390 paid or reimbursed by an employer for qualified adoption expenses may be excludable from income. This is a “per child” amount.
- Must be under an adoption assistance program.
- Subject to limitations. Non qualified payments must be included in income.

Tax liability limitation

- Tax liability, reduced by:
 - 1. credit for child & dependent care
 - 2. credit for the elderly or disabled
 - 3. education credits
 - 4. retirement savings contribution credit
 - 5. child tax credit
 - 6. mortgage interest credit

Carry forward of credit

- If the adoption credit exceeds the limit, taxpayers can carry forward the unused adoption credit for up to 5 years.



Computation example:

- In 2002, Paul and Patty adopted a child. Finalization took place in 2003. They are eligible to claim the credit on their 2003 return.
- Their tax liability was \$4,654 before credits. They were eligible to claim a \$5,200 adoption credit, and \$480 of child care credit.

Computation

- Allowable adoption credit for 2003 as follows:

Tax liability	\$4,654
Less child care credit	<u>(480)</u>
Balance	\$4,174
Adoption credit applied	\$4,174
Unused credit to carry-forward to 2004 return	<u>\$1,026</u>

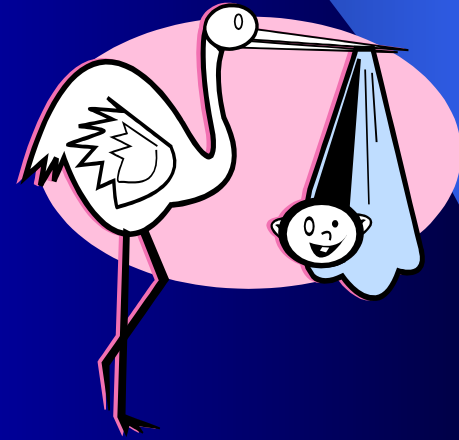
Summary

- Credit or exclusion up to \$10,390
- Must be qualified expenses for qualified child.
- Must meet filing requirements and income limitation.
- If exclusion, must be under qualified adoption assistance program.

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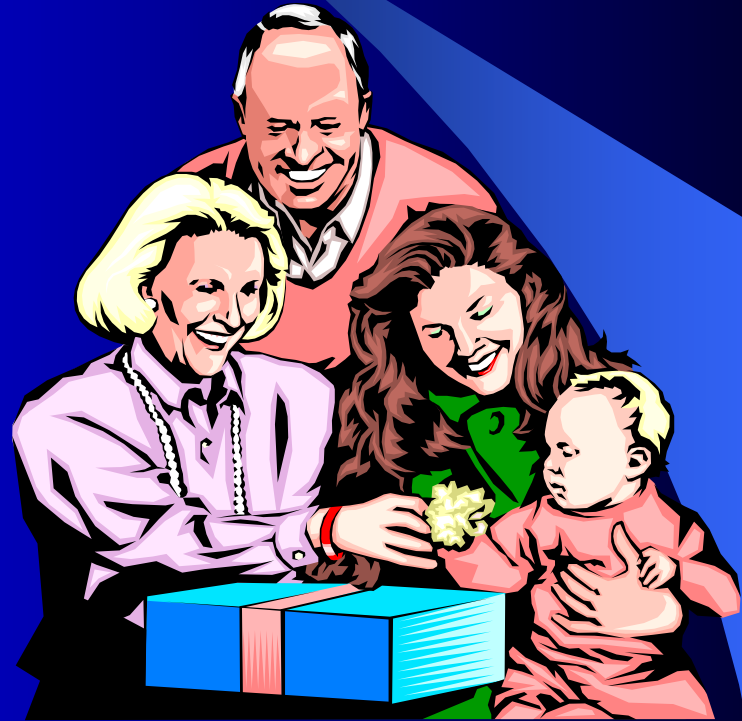
Summary (continued)

- Must reduce tax liability by other credits first.
- May carry forward credit for up to 5 years.
- Must complete form 8839, providing child's identifying number.



ID State Adoption deduction

- You can deduct qualified expenses up to \$3,000 per child, in the year paid. Travel expenses do not qualify.
- If attempt is unsuccessful, must amend any prior year deductions.



Where to Get More Information

- Publication 968 & Publication 17
- Form 8839 and instructions
- www.irs.gov
- (801)262-5403
Donald Nelson, or
(208)846-8431
(home).

